

CRS Report for Congress

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U.S. International Trade: Trends and Forecasts

Updated November 22, 2006

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Report Documentation Page			Form Approved OMB No. 0704-0188	
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1. REPORT DATE 22 NOV 2006	2. REPORT TYPE	3. DATES COVERED 00-00-2006 to 00-00-2006		
4. TITLE AND SUBTITLE U.S. International Trade: Trends and Forecasts		5a. CONTRACT NUMBER		
		5b. GRANT NUMBER		
		5c. PROGRAM ELEMENT NUMBER		
6. AUTHOR(S)		5d. PROJECT NUMBER		
		5e. TASK NUMBER		
		5f. WORK UNIT NUMBER		
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Congressional Research Service,The Library of Congress,101 Independence Ave, SE,Washington,DC,20540-7500		8. PERFORMING ORGANIZATION REPORT NUMBER		
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)		10. SPONSOR/MONITOR'S ACRONYM(S)		
		11. SPONSOR/MONITOR'S REPORT NUMBER(S)		
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited				
13. SUPPLEMENTARY NOTES				
14. ABSTRACT				
15. SUBJECT TERMS				
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 28
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified		

U.S. International Trade: Trends and Forecasts

Summary

This report provides an overview of the current status, trends, and forecasts for U.S. international trade. The purpose of this report is to provide current data and brief explanations for the various types of trade flows along with a short discussion of particular trends and points of contention related to trade policy.

The United States is now running record level deficits in its trade with other nations. In 2005 the U.S. merchandise trade deficit reached \$766 billion on a census basis and \$783 billion on a balance-of-payments basis (BoP). A surplus in services trade of \$66 billion gave a deficit of \$717 billion on goods and services for the year — up \$105 billion or 17.2% from the \$611 billion deficit in 2004. While U.S. exports are highly competitive in world markets, these sales abroad are overshadowed by the huge demand by Americans for imported products. In 2005, U.S. exports of goods and services totaled \$1.275 trillion, while U.S. imports reached \$1.992 trillion (BoP). Since 1976, the United States has incurred continual merchandise trade deficits with annual amounts fluctuating around an upward trend.

Trade deficits are a concern for Congress because they may generate trade friction and pressures for the government to do more to open foreign markets, to shield U.S. producers from foreign competition, or to assist U.S. industries to become more competitive. As the deficit increases, the risk also rises of a precipitous drop in the value of the dollar and disruption in financial markets.

Overall U.S. trade deficits reflect a shortage of savings in the domestic economy and a reliance on capital imports to finance that shortfall. Capital inflows serve to offset the outflow of dollars used to pay for imports. Movements in the exchange rate help to balance trade. The rising trade deficit (when not matched by capital inflows) places downward pressure on the value of the dollar which, in turn, helps to shrink the deficit by making U.S. exports cheaper and imports more expensive. Central banks in countries, such as China, however, have intervened in foreign exchange markets to keep the value of their currencies stable.

The broadest measure of U.S. international economic transactions is the balance on current account. In addition to merchandise trade, it includes trade in services and unilateral transfers. In 2005, the current account deficit rose to \$791.5 billion from \$665.3 billion in 2004. In trade in advanced technology products, the U.S. balance dropped from a surplus of \$32.2 billion in 1997 to a deficit of \$44.4 billion in 2005. In trade in passenger automobiles, the \$93 billion U.S. deficit was mainly with Canada, Germany, Korea, Japan, and Mexico. In imports of crude oil, major sources of the \$176 billion in imports were Venezuela, Saudi Arabia, Canada, Mexico, and Nigeria.

This report replaces CRS Issue Brief IB96038, *U.S. International Trade: Data and Forecasts*, by Dick K. Nanto and Thomas Lum, and will be updated periodically.

Contents

Most Recent Developments	1
The U.S. Deficit in International Trade	2
Savings Shortfalls and the Trade Deficit	3
Implications of the Trade Deficit	3
Types of Trade Data	5
U.S. Merchandise Trade Balance	5
Merchandise Trade Balance in Volume Terms	9
Current Account Balance	10
Forecasts	12
U.S. Trade with Selected Nations	13
Advanced Technology, Autos, and Oil	19
Some Common Perceptions	21
Outsourcing	21
Is the Trade Deficit at a Dangerous Level?	22
Is Trade with China Merely Replacing that with Southeast Asia?	23

List of Figures

Figure 1. U.S. Balances of Trade in Goods and Services by Month, 2005 and 2006 (in current dollars)	1
Figure 2. U.S. Merchandise Exports, Imports, Trade Balance, and Real Effective Dollar Exchange Rate Index, 1982-2005	6
Figure 3. Annual Growth in U.S. Merchandise Exports and Imports, 1982-2005	7
Figure 4. Real U.S. Imports, Exports, and Trade Balance of Goods (chained 2000 dollars), 1990-2005	9
Figure 5. U.S. Current Account and Merchandise Trade Balances, 1982-2005	10
Figure 6. U.S. Merchandise Trade and Current Account Deficits 1997-2008 (forecast, in current dollars)	13
Figure 7. U.S. Merchandise Trade Balances with Selected Nations, 2005	14
Figure 8. Shares of U.S. Imports of Manufactures by Affiliation of Foreign Producer, 1982-2003	22
Figure 9. The U.S. Current Account Deficit as a Percent of Gross Domestic Product, 1985-2008 (forecast)	23

List of Tables

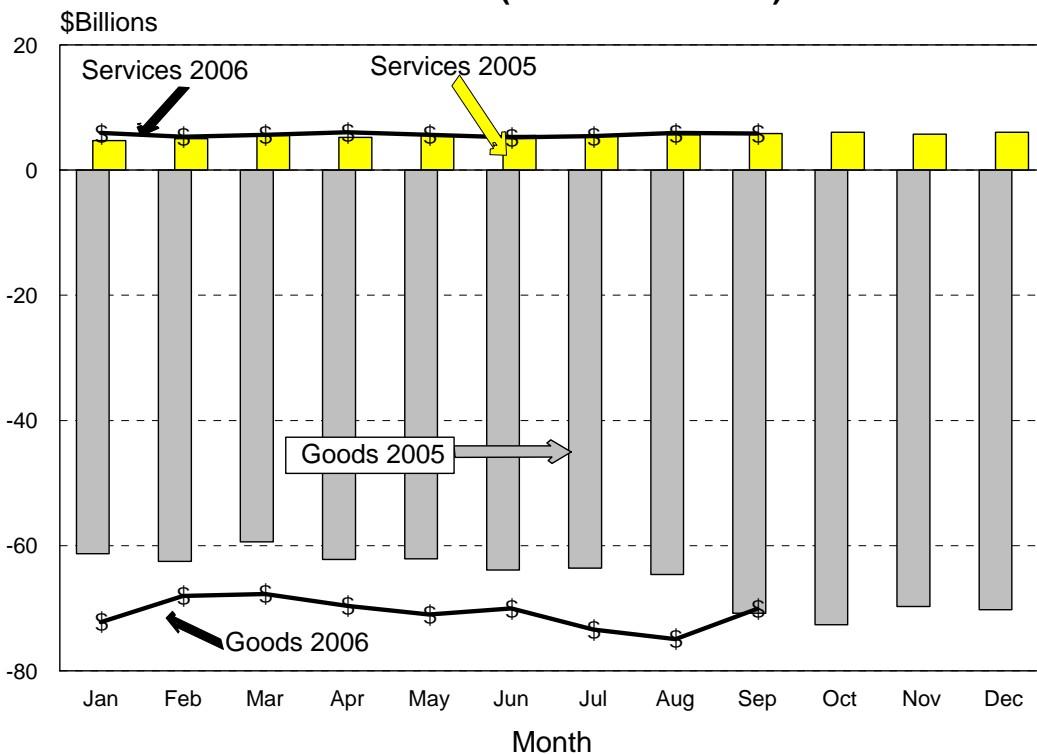
Table 1. U.S. Exports, Imports, and Merchandise Trade Balances, 1982-2005	8
Table 2. U.S. Merchandise Trade in Volume Terms, 2001-2005	10
Table 3. U.S. Current Account Balances: 1985-2005	11
Table 4. U.S. Merchandise and Current Account Trade 2002 to 2008 (forecast)	12
Table 5. U.S. Merchandise Trade Balances with Selected Nations: 2000-2005	15
Table 6. Top U.S. Merchandise Deficit Trading Partners, 2005	16
Table 7. Top U.S. Trading Partners Ranked by Total Merchandise Trade in 2005	17
Table 8. U.S. Current Account Balances With Selected U.S. Trading Partners, 2005	18
Table 9. U.S. Trade in Advanced Technology Products	19
Table 10. U.S. Trade in Passenger Automobiles by Selected Countries, 2005 ..	20
Table 11. U.S. Imports of Crude Oil by Selected Countries, 2005	20

U.S. International Trade: Trends and Forecasts

Most Recent Developments

In 2005, the trade deficit in goods at a record \$782.7 billion (balance of payments [BoP] basis), was 17.5% higher than in 2004. The 2005 deficit on goods trade with China was \$201.6 billion (Census basis), with the European Union (EU-15) was \$122.4 billion, with Japan was \$82.7 billion, with Canada was \$76.5 billion, with Mexico was \$50.1 billion, and with the Asian Newly Industrialized Countries (Hong Kong, South Korea, Singapore, and Taiwan) was \$15.9 billion. Merchandise imports of \$1,677.4 billion increased by 12% — particularly of crude oil (up \$43.8 billion), capital goods except automotive (up \$36.1 billion), automotive vehicles and parts (up \$11.7 billion), and consumer goods (up \$34.1 billion). Merchandise exports of \$894.6 billion rose by 11%, particularly of industrial supplies (up \$27.8 billion), capital goods except automotive (up \$30.3 billion), automotive vehicles and parts (up \$8.5 billion), and consumer goods (up \$12.4 billion), but this was not enough to narrow the trade deficit.

**Figure 1. U.S. Balances of Trade in Goods and Services by Month,
2005 and 2006 (in current dollars)**



Source: CRS with Data from the U.S. Department of Commerce

Year-to-date (January-September 2006), the U.S. trade deficit in goods and services, at \$586.2 billion, was 12% higher compared to the same period in 2005. The year-to-date deficit on goods trade with China (Census basis) was \$166.3 billion, with Japan was \$64.8 billion, with OPEC was \$63.2 billion, with the European Union was \$70.6 billion, with Canada was \$56.6 billion, and with Mexico was \$48.5 billion. As can be seen in **Figure 1**, the U.S. merchandise trade deficit has increased over the corresponding month in 2005, while the services balance has remained steady with a small surplus.

For 2005, the trade deficit on goods and services reached a record \$717 billion or 5.7% of gross domestic product. This upward trend is expected to continue into 2006. U.S. consumer demand remains strong and continues to pull in imports at a rapid pace. The rest of the world is not growing fast enough to generate the vigorous export growth needed to hold the deficit steady — let alone reduce it.

The U.S. Deficit in International Trade

International trade in goods and services along with flows of financial capital affect virtually every person living in the United States. Whether buying imported clothes, gasoline, computers or cars or working in an industry that competes with imports or sells products abroad, the influence of international trade on economic activity is ubiquitous.

The United States is now running record deficits in its trade with other nations. In 2005 the U.S. merchandise trade deficit reached \$766 billion on a census basis and \$783 billion on a balance-of-payments basis (BoP). A surplus in services trade of \$66 billion produced a deficit of \$717 billion on goods and services for the year — up \$105 billion or 17.2% from the \$611 billion deficit in 2004. While U.S. exports are highly competitive in world markets, U.S. sales abroad are overshadowed by the huge demand by Americans for imported products. In 2005, U.S. exports of goods and services totaled \$1.275 trillion, while U.S. imports reached \$1.992 trillion (BoP). Since 1976, the United States has incurred continual merchandise trade deficits with annual amounts fluctuating around an upward trend.

For the Congress, the trade deficit and other aspects of international trade enter into public policy considerations through many portals. At the macroeconomic level, trade deficits are a concern because they affect U.S. economic growth, interest rates, labor, and the debt load of the economy. As the trade deficit rises relative to the total economy, the risk increases that the dollar will weaken, raise prices, disrupt financial markets, and reduce the economic well being of the population. On the strategic level, trade ties often lead to a deepening of bilateral relations with other nations that can develop into formal free trade agreements or political and security arrangements. Trade also can be used as a tool to accomplish strategic objectives — particularly through providing preferential trading arrangements or by imposing trade sanctions.

On the microeconomic side, imports of specific products can generate trade friction and pressures from constituent interests for the government to shield U.S.

producers from foreign competition, provide adjustment assistance, open foreign markets, or assist U.S. industries to become more competitive.

This report provides an overview of the current status, trends, and forecasts for U.S. import and export flows as well as certain balances. The purpose of this report is to provide current data and brief explanations for the various types of trade flows along with a brief discussion of trends that may require attention or point to the need for policy changes. The use of trade policy as an economic or strategic tool is beyond the scope of this report but can be found in various other CRS reports.¹ Further detail on trade in specific commodities, with particular countries or regions, or for different time periods, can be obtained from the Department of Commerce,² U.S. International Trade Commission,³ or by contacting the author of this report.

Savings Shortfalls and the Trade Deficit

Overall U.S. trade deficits reflect a shortage of savings in the domestic economy and a reliance on capital imports to finance that shortfall. A savings shortfall is the analogue of excessive spending that is financed by borrowing. Households borrow for consumption; businesses borrow to invest; and the government borrows to cover its budget deficit. At the international transaction level, the savings shortfall is manifest when the United States imports capital to pay for its excess of imports (trade deficit).

Whether this foreign borrowing is beneficial for the U.S. economy depends on how the imports of capital are used. If they are used to finance investments that generate a future return at a sufficiently high rate (they raise future output and productivity), then they may increase the well being of current and future generations. However, if the imports are used only for current consumption, the net effect of the borrowing will be to shift the burden of repayment to future generations without a corresponding benefit to them.

Implications of the Trade Deficit

U.S. trade balances are macroeconomic variables that may or may not indicate underlying problems with the competitiveness of particular industries or what some refer to as the competitiveness of a nation. The reason is that overall trade flows are determined, within the framework of institutional barriers to trade and the activities of individual industries, primarily by macroeconomic factors such as rates of growth,

¹ See, for example, CRS Report RL31832, *The Export Administration Act: Evolution, Provisions, and Debate*, by Ian F. Fergusson; CRS Report RS22183, *Trade Preferences for Developing Countries and the WTO*, by Jeanne J. Grimmett; CRS Report RL33463, *Trade Negotiations During the 109th Congress*, by Ian F. Fergusson; CRS Report RL32371, *Trade Remedies: A Primer*, by Vivian C. Jones; CRS Report RS20889, *Textile and Apparel Quota Phaseout: Some Economic Implications*, by Bernard A. Gelb; CRS Report RL31910, *China: Economic Sanctions*, by Dianne E. Rennack; or CRS Report RL32493, *The North Korean Economy: Background and Policy Analysis*, by Dick K. Nanto and Emma Chanlett-Avery.

² Commerce Department data are available at [<http://www.bea.gov/bea/di1.htm>].

³ U.S. International Trade Commission data are available at [<http://dataweb.usitc.gov/>].

savings and investment behavior (including government budget deficits/surpluses), international capital flows, and exchange rates.⁴

Increases in trade deficits may diminish economic growth, since net exports (exports minus imports) are a component of gross domestic product. In the late 1980s and early 1990s, export growth was an important element in overall U.S. economic growth. In 1999, merchandise exports accounted for about 8.5% of GDP, compared with 5.9% in 1990. Recently, however, rising trade deficits have reduced total domestic demand in the economy, but the weakness in the trade sector has been offset by strong consumer, business, and government demand.

Many economists fear that the rising U.S. trade and current account⁵ deficits could lead to a large drop in the value of the U.S. dollar. The current account deficit now exceeds 6% of GDP and is placing downward pressure on the dollar. If foreign investors stop offsetting the deficit by buying dollar-denominated assets, the value of the dollar could drop — possibly precipitously. In that case, U.S. interest rates would have to rise to attract more foreign investment; financial markets could be disrupted; and inflationary pressures could increase. In the International Monetary Fund's May 2006 consultation with the United States, for example, its directors reiterated their long-standing concerns about the large U.S. current account deficit. They stated that "there is broad agreement that the large U.S. current account deficit ... cannot be sustained indefinitely. Although a gradual adjustment is the most likely outcome, delaying progress increases the risk of fanning protectionist sentiment or disorderly foreign exchange market conditions."⁶

Currently, foreign investment in dollar assets along with purchases of securities by central banks of countries, such China and Japan, have been sufficient to keep the value of the dollar from falling too far. These central banks have intervened in currency markets to keep their exchange rates relatively stable with respect to the dollar, although Japan claims not to have intervened since spring of 2004. This intervention adds to the foreign currency reserves held by these countries. Japan's central bank held \$858 billion in foreign currency reserves (end of August 2006), and the Bank of China held \$941 billion (end of June 2006). In U.S. Treasury securities, as of July 2006, Japan held \$637 billion and China \$333 billion.⁷ On July 21, 2005, China announced a 2.1% revaluation of its currency, but the value of the renminbi has appreciated only slightly since then (indicating that China may still be intervening in currency markets).⁸

⁴ For further information on trade deficits and the macroeconomy, see CRS Report RL31032, *The U.S. Trade Deficit: Causes, Consequences, and Cures*, by Craig K. Elwell.

⁵ U.S. trade in goods and services plus net flows of investment income and remittances.

⁶ IMF, 2005 Article IV Consultation with the United States of America. Concluding Statement of the IMF Mission. May 31, 2006.

⁷ For further information, see CRS Report RS22331, *Foreign Holdings of Federal Debt*, by Justin Murray and Marc Labonte.

⁸ For further information, see CRS Report RL32165, *China's Currency: Economic Issues and Options for U.S. Trade Policy*, by Wayne M. Morrison and Marc Labonte.

How long can the United States keep running trade deficits? U.S. deficits in trade can continue for as long as foreign investors are willing to buy and hold U.S. assets, particularly government securities and other financial assets.⁹ Their willingness depends on a complicated array of factors including the perception of the United States as a safe haven for capital, relative rates of return on investments, interest rates on U.S. financial assets, actions by foreign central banks, and the savings and investment decisions of businesses, governments, and households. The policy levers that influence these factors affecting the trade deficit are held by the Federal Reserve¹⁰ (interest rates) as well as both Congress and the Administration (government budget deficits and trade policy), and their counterpart institutions abroad.

Types of Trade Data

The U.S. government compiles trade data in four different ways. The data on goods trade are first compiled on a census basis. Bilateral and sectoral data are reported only on a census basis. The census numbers are then adjusted and reported monthly on a balance of payments (BoP) basis that includes adjustments for valuation, coverage, and timing and excludes military transactions. The data are finally reported in terms of national income and product accounts (NIPA). The NIPA data also can be further adjusted to include correcting for inflation to gauge movement in trade volumes as distinct from trade values. Conceptually, this procedure is analogous to adjusting macroeconomic data from nominal to real values.

The Census Bureau also reports imports on a c.i.f. (cost-insurance-freight) basis which includes the value of insurance, international shipping, and other charges incurred in bringing merchandise to U.S. ports of entry. The customs (or f.a.s. — free-alongside-ship) data do not include these supplementary costs. U.S. import data are reported on a customs basis with insurance and freight charges counted in U.S. services trade. Other countries, however, commonly report merchandise import figures that include insurance and freight charges. This tends to overstate their imports and understate their trade surpluses with the United States.

U.S. Merchandise Trade Balance

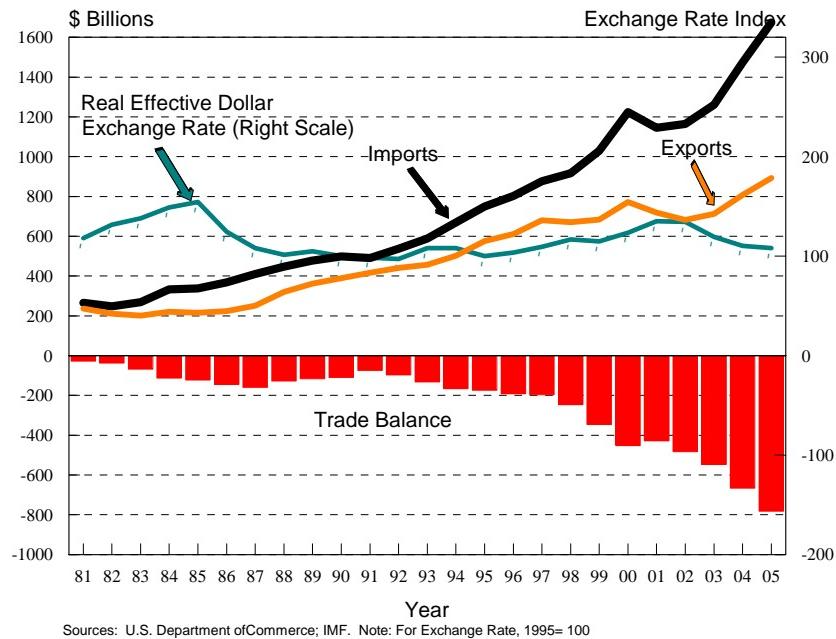
The merchandise (goods) trade balance is the most widely known and frequently used indicator of U.S. international economic activity (see **Figure 2**). In 2005, total U.S. merchandise trade on a balance of payments (BoP) basis amounted to \$2.67 trillion, with exports of \$895 billion and imports of \$1,677 billion. The U.S. merchandise trade deficit rose 17% in 2005 to \$783 billion following a 22% rise in 2004. Prior to 1992, the deficit had decreased for four consecutive years, from a previous peak of \$159.6 billion in 1987 to \$76.9 billion in 1991. The increase in the

⁹ See Mann, Catherine L. *Is the U.S. Trade Deficit Sustainable?* Washington, Institute for International Economics, 1999. 224 p. See also: CRS Report RS21409, *The Budget Deficit and the Trade Deficit: What Is Their Relationship?* by Marc Labonte and Gail Makinen.

¹⁰ For details, see CRS Report RS20826, *Structure and Functions of The Federal Reserve System*, by Pauline Smale.

trade deficit in recent years has been due largely to sluggish demand for U.S. exports and rising demand for imports caused primarily by capital inflows into the U.S. market, slow economic recoveries in other countries, and faster economic growth in the United States. As a share of gross domestic product (GDP), the deficit on goods trade rose from 1.9% in 1990 to 5.1% in 2003 and 6.3% in 2005.

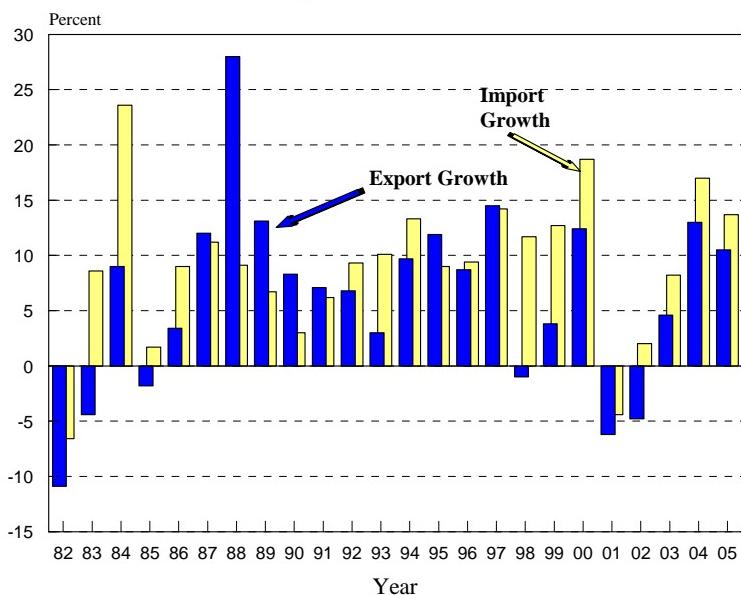
Figure 2. U.S. Merchandise Exports, Imports, Trade Balance, and Real Effective Dollar Exchange Rate Index, 1982-2005



Sources: U.S. Department of Commerce; IMF. Note: For Exchange Rate, 1995= 100

As for U.S. merchandise exports (as shown in **Table 1** and **Figure 2**), they decreased in 2001 and 2002 in response to the global slowdown, but they generally have been increasing each year. As shown in **Figure 3**, the growth of imports has also been steady, although they too fell by 4.4% in 2001 before recovering in 2002. In 2003, import growth was nearly double export growth, although in 2004, export growth almost caught up with that of imports, and in 2005, both dropped slightly (11% for exports and 14% for imports). Since U.S. imports are about 88% greater than U.S. exports, exports must grow 88% faster than imports just for the deficit to remain constant.

Figure 3. Annual Growth in U.S. Merchandise Exports and Imports, 1982-2005



Source: Underlying data from U.S. Department of Commerce

Table 1. U.S. Exports, Imports, and Merchandise Trade Balances, 1982-2005
 (billions of U.S. dollars)

Year	Census basis			Balance of payments basis		
	Exports (f.a.s. ^a)	Imports (customs ^b)	Trade Balance	Exports (f.a.s. ^a)	Imports (customs ^b)	Trade Balance
1982	212.3	243.9	-31.6	211.2	247.6	-36.4
1983	201.7	261.7	-60.0	201.8	268.9	-67.1
1984	218.7	330.5	-111.8	219.9	332.4	-112.5
1985	212.6	336.4	-123.8	215.9	338.1	-122.2
1986	226.4	365.7	-139.3	223.3	368.4	-145.1
1987	253.9	406.3	-152.4	250.2	409.8	-159.6
1988	323.3	441.9	-118.6	320.2	447.2	-127.0
1989	362.9	473.4	-110.5	359.9	477.7	-117.8
1990	392.9	495.2	-102.3	387.4	498.4	-111.0
1991	421.8	487.1	-65.3	414.1	491.0	-76.9
1992	448.2	532.6	-84.4	439.6	536.5	-96.9
1993	464.8	580.5	-115.7	456.9	589.4	-132.5
1994	512.6	663.2	-150.6	502.9	668.7	-165.8
1995	584.7	743.5	-158.8	575.2	749.4	-174.2
1996	625.1	795.3	-170.2	612.1	803.1	-191.0
1997	689.2	869.7	-180.5	678.4	876.5	-198.1
1998	682.1	911.9	-229.8	670.4	917.1	-246.7
1999	695.8	1,024.6	-328.8	684.0	1,030.0	-346.0
2000	781.9	1,218.0	-436.1	772.0	1,224.4	-452.4
2001	730.9	1,142.3	-411.4	718.7	1,145.9	-427.2
2002	693.5	1,163.6	-470.1	681.8	1,164.7	-482.9
2003	724.8	1,257.1	-532.3	713.1	1,260.7	-547.6
2004	818.8	1,469.7	-650.9	807.5	1,472.9	-665.4
2005	906.0	1,673.5	-767.5	894.6	1,677.4	-782.8

Source: U.S. Department of Commerce, Bureau of Economic Analysis, U.S. International Transactions Accounts Data.

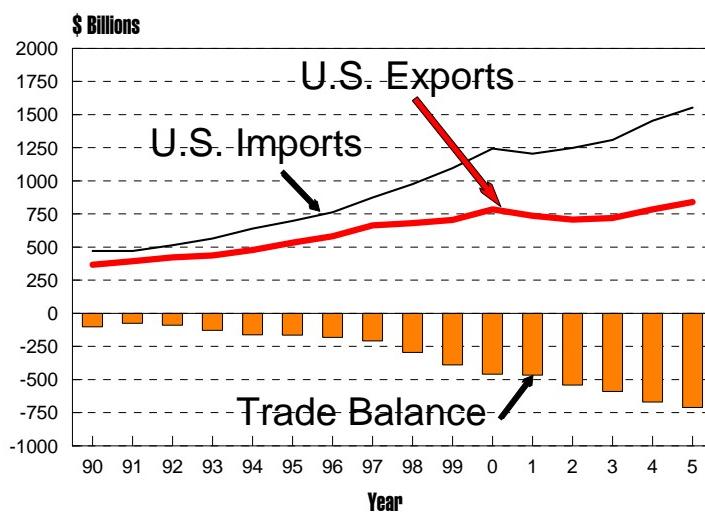
Note: Goods on a Census basis are adjusted to a Balance of Payments basis to include changes in ownership that occur without goods passing into or out of the customs territory of the United States, to eliminate duplication, and to value transactions according to a standard definition. Export adjustments include counting military sales as services not goods, adding private gift parcels, and foreign official gold sales from U.S. private dealers. Import adjustments include adding in inland freight in Canada and foreign official gold sales to U.S. private dealers, and subtracting imports by U.S. military agencies.

- a. Exports are valued on the f.a.s. basis, which refers to the free-alongside-ship value at the port of export and generally includes inland freight, insurance, and other charges incurred in placing the goods alongside the carrier at the port of exportation.
- b. Imports are valued as reported by the U.S. Customs Service and excludes import duties, the cost of freight, insurance, and other charges incurred in bringing merchandise to the United States.

Merchandise Trade Balance in Volume Terms

Like other economic variables, exports and imports, reported in terms of their values, can change merely because prices change. Trade data, therefore, can be adjusted for inflation by dividing by a chained price index (chained price indexes are weighted by two-year averages) to generate real or volume data (some trade commodities actually are reported in volume terms [e.g., tons of wheat]). The real data provide a more accurate picture of how the underlying flows of merchandise are changing. As with the nominal trade deficit, the real deficit continues to widen.

Figure 4. Real U.S. Imports, Exports, and Trade Balance of Goods (chained 2000 dollars), 1990-2005



Source: CRS with data from U.S. Bureau of Economic Analysis

As shown in **Table 2** and **Figure 4**, the constant-dollar value, or physical volume, of merchandise exports increased by 7.3% in 2005, down slightly from 8.8% in 2004 but up from 2.6% in 2003, -4.5% in 2002, and 6.3% in 2001. The physical volume of imports rose by 6.9% in 2005, down from 10.8% in 2004 but up from 5.4% in 2003, 3.4% in 2002, and a fall of 3.6% in 2001. Because the growth of merchandise imports is higher than the growth of exports and because imports exceed exports by more than 80% on a physical volume basis, exports would have to grow more than 80% faster than imports just for the U.S. trade deficit in terms of volume to remain constant. In 2005, export growth actually exceeded import growth, but the deficit still increased. In recent years, the deficit in volume terms has varied relative to the deficit in value terms partly because of fluctuations in oil import prices (when oil prices rise, the deficit in value rises relative to that in volume terms).

Table 2. U.S. Merchandise Trade in Volume Terms, 2001-2005
 (billions of chained 2000 dollars)

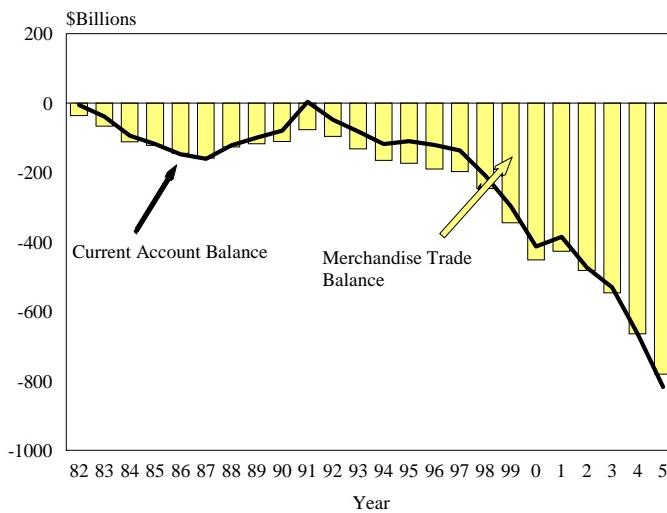
Year	Exports	Export Growth	Imports	Import Growth	Net Exports
2001	736.3	-6.1	1,204.1	-3.2	-467.8
2002	707.0	-4.0	1,248.2	3.7	-541.2
2003	719.7	1.8	1,309.2	4.9	-589.5
2004	783.6	8.9	1,452.7	11.0	-669.1
2005	841.1	7.3	1,553.0	6.9	-711.9

Source: Bureau of Economic Analysis, National Income and Products Accounts Table.

Current Account Balance

The current account provides a broader measure of U.S. trade because it includes services, investment income, and unilateral transfers in addition to merchandise trade. (See **Figure 5.**) The balance on services includes travel, transportation, fees and royalties, insurance payments, and other government and private services. The balance on investment income includes income received on U.S. assets abroad minus income paid on foreign assets in the United States. Unilateral transfers are international transfers of funds for which there is no *quid pro quo*. These include private gifts, remittances, pension payments, and government grants (foreign aid). Data on the current account lag those on trade by several months.

Figure 5. U.S. Current Account and Merchandise Trade Balances, 1982-2005



Source: CRS with data from U.S. Bureau of Economic Analysis

Table 3 summarizes the components of the U.S. current account. In 2005, the U.S. deficit on current account increased to \$791.5 billion from \$665.3 billion in 2004. In 2006, it is forecast to rise to about \$884 billion. As a share of U.S. GDP, this deficit rose to 6.3% in 2005 — considerably above the caution level used by the International Monetary Fund of 5%. Historically, the current account deficit fell from a then record-high \$160.7 billion in 1987 to \$79.0 billion in 1990, and switched to a \$3.7 billion surplus in 1991 (primarily because of payments to fund the Gulf War

by Japan and other nations). However, since 1992, the current account deficit has been increasing significantly except for a slight dip in 2001 because of the U.S. recession.

Since the merchandise trade balance comprises the greater part of the current account, the two tend to track each other. Unlike the merchandise trade balance, however, the services account has been in surplus since 1975. In 2005, the United States surplus in its services trade was \$66.0 billion. Since Americans are such large investors in foreign economies, the United States traditionally also has had a surplus in its investment income. This surplus on income from investments, which reached a high of \$89.8 billion in 1997, dropped to \$52.5 billion in 2003, rebounded in 2004, and rose further to \$66.0 billion in 2005. The deficit in unilateral transfers (primarily dollars sent abroad by foreign workers and recent immigrants) at \$86.1 billion in 2005 reflects a rising trend and is more than double the level of the late-1980s. This largely offsets the U.S. surplus in services and investment income.

Table 3. U.S. Current Account Balances: 1985-2005
(billions of U.S. dollars)

Calendar Year	Merchandise Trade Balance ^a	Services Balance ^b	Investment Income Balance ^c	Net Unilateral Transfers ^d	Current Account Balance ^e
1985	-122.2	0.3	25.7	-22.0	-118.2
1986	-145.1	6.5	15.5	-24.1	-147.2
1987	-159.6	7.9	14.3	-23.3	-160.7
1988	-127.0	12.4	18.7	-25.3	-121.2
1989	-117.7	24.6	19.8	-26.2	-99.5
1990	-111.0	30.2	28.6	-26.7	-79.0
1991	-76.9	45.8	24.1	10.8	3.7
1992	-96.9	57.8	24.2	-33.1	-48.0
1993	-132.5	62.3	25.3	-37.1	-82.0
1994	-165.8	67.4	17.1	-36.8	-118.0
1995	-174.2	77.9	20.9	-34.1	-109.5
1996	-191.0	87.1	22.3	-38.6	-120.2
1997	-198.1	89.8	12.6	-45.2	-140.9
1998	-246.7	81.7	4.3	-53.2	-214.9
1999	-346.0	82.6	13.9	-50.6	-300.1
2000	-452.4	74.1	21.0	-58.8	-416.4
2001	-427.2	64.5	25.2	-51.9	-389.4
2002	-482.9	61.1	10.0	-64.0	-475.2
2003	-547.3	52.5	46.3	-71.2	-519.7
2004	-665.3	54.1	27.6	-81.6	-665.3
2005	-782.7	66.0	11.3	-86.1	-791.5

Source: U.S. Bureau of Economic Analysis, U.S. International Transactions. On Internet at [http://www.bea.gov/bea/international/bp_web/list.cfm?anon=71].

- a. On a balance-of-payments basis.
- b. Includes travel, transportation, fees and royalties, insurance payments, other government and private services, and investment income.
- c. Income receipts on U.S. assets abroad minus income payments on foreign assets in the U.S.
- d. International transfers of funds, such as private gifts, pension payments, and government grants for which there is no *quid pro quo*.
- e. The trade balance plus the service balance plus investment income balance plus net unilateral transfers, although conceptually equal to the current account balance, may differ slightly as a result of rounding.

Forecasts

According to Global Insight, Inc., a leading U.S. economic forecasting firm, in 2006 the U.S. merchandise (goods) trade deficit is projected to increase to about \$855 billion on a balance-of-payments basis. In 2007, this deficit is expected to rise to about \$861 billion before declining somewhat in 2008 (see **Table 4** and **Figure 6**). The U.S. current account deficit likewise is projected to from \$792 billion in 2005 to \$884 billion in 2006 and further to \$894 billion in 2007 and then decline somewhat in 2008.

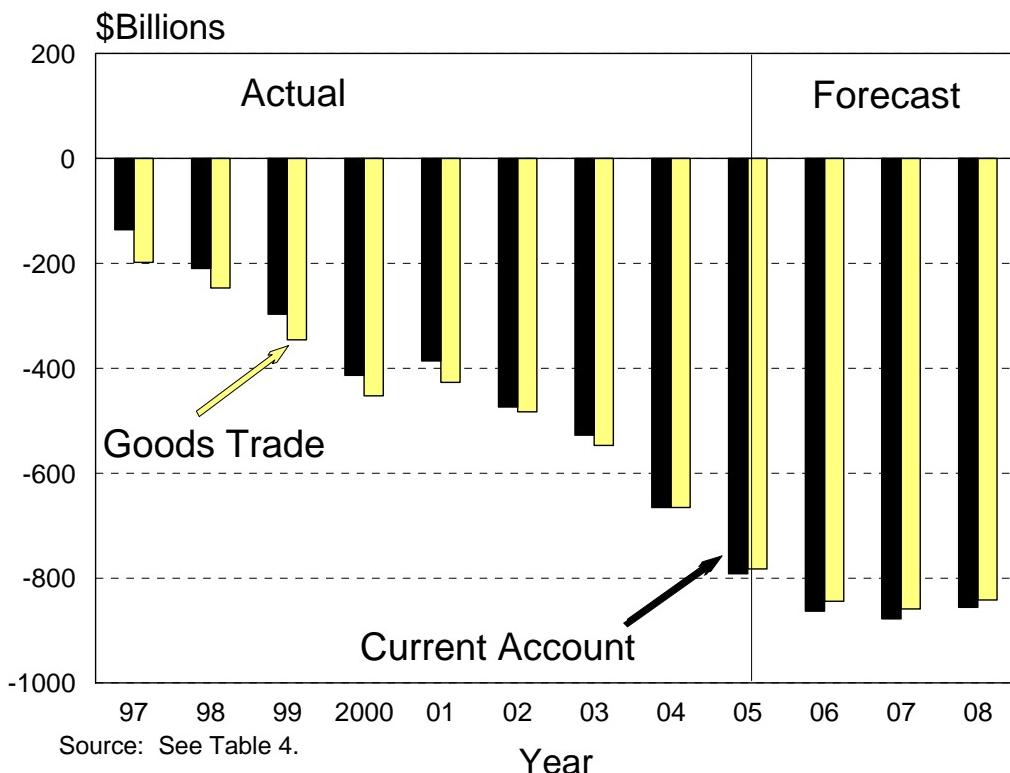
**Table 4. U.S. Merchandise and Current Account Trade
2002 to 2008 (forecast)**
(billions of U.S. dollars)

	Forecast						
	2002	2003	2004	2005	2006	2007	2008
Merchandise Trade							
Exports							
Actual	682.4	713.4	807.5	894.6	—	—	—
Global Insight	—	—	—	—	1,038.5	1,162.2	1,273.2
Imports							
Actual	1164.7	1260.7	1472.9	1,677.4	—	—	—
Global Insight	—	—	—	—	1,896.7	2,034.8	2,128.5
Trade Balance							
Actual	-482.3	-547.3	-665.4	-782.7	—	—	—
Global Insight	—	—	—	—	-844.0	-858.7	-841.8
Services Trade Balance							
Actual	61.1	52.5	54.1	66.0	—	—	—
Global Insight	—	—	—	—	71.6	98.1	127.9
Current Account Balance							
Actual	-475.2	-519.7	-665.3	-791.5	—	—	—
Global Insight	—	—	—	—	-863.1	-877.7	-855.9

Sources: U.S. Bureau of Economic Analysis, December 2005; Global Insight, *Interim Annual Forecast*, September 2006. Balance-of-payments basis.

Note: Global Insight was created through the 2002 merger of Standard & Poor's *Data Resources Inc.* (*DRI*) and Wharton Econometric Forecasting Associates (*WEFA*).

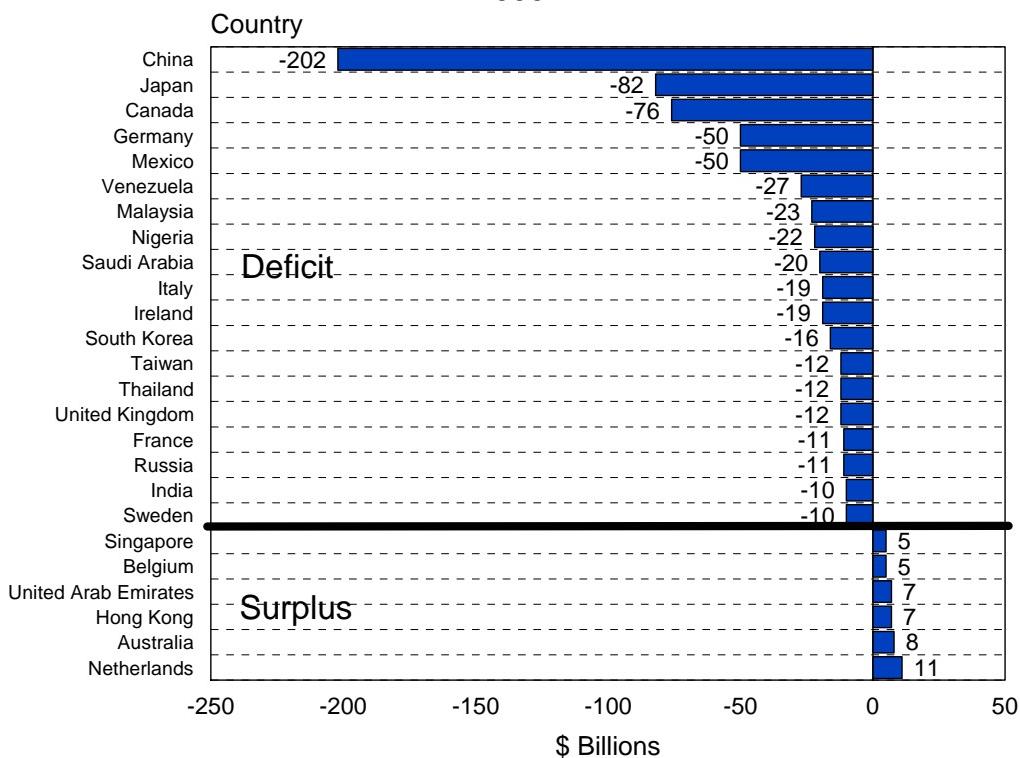
**Figure 6. U.S. Merchandise Trade and Current Account Deficits
1997-2008 (forecast, in current dollars)**



U.S. Trade with Selected Nations

The overall U.S. merchandise trade balance consists of deficits or surpluses with all trading partners. Many economists view the overall figure as more significant than bilateral trade balances, since rising deficits with some nations are often offset by declining deficits or growing surpluses with others. Nonetheless, abnormally large or rapidly increasing trade deficits with particular countries are often viewed as indicators that underlying problems may exist with market access, the competitiveness of particular industries, currency misalignment, or macroeconomic adjustment. **Figure 7** and **Table 5** show U.S. trade balances with selected nations.

Figure 7. U.S. Merchandise Trade Balances with Selected Nations, 2005



Source: CRS with data from the U.S. Department of Commerce

Most of the U.S. trade deficit can be accounted for by trade with China, Japan, Canada, Mexico, and Germany. Trade with the oil exporting countries, particularly Venezuela, Nigeria, and Saudi Arabia, also is in deficit. U.S. trade surpluses occur in trade with the Netherlands, Australia, Hong Kong, and the United Arab Emirates.

The U.S. trade deficit with China has soared over the past decade. From \$32 billion in 1995 to \$100 billion in 2000 and \$202 billion in 2005, the negative net balance in trade with China has grown to account for 26% of the total U.S. trade deficit.¹¹ The U.S. trade deficit with China exceeded that with Japan for the first time in the year 2000 and now is more than twice as large.

China claims that its trade is less imbalanced than U.S. data indicate. Chinese trade data differ from those of the United States primarily because of the treatment of Hong Kong as an entrepot. Since Hong Kong is a separate customs area from mainland China, Beijing counts Hong Kong as the destination for its exports sent there, even though the goods may be transshipped to other markets. For example, China would count a laptop computer that is assembled in Shanghai but shipped through Hong Kong before being exported to the United States as a sale to Hong Kong. By contrast, the United States and many of China's other trading partners count Chinese exports that are transshipped through Hong Kong as products from

¹¹ For details and policy discussion, see CRS Report RL31403, *China's Trade with the United States and the World*, by Thomas Lum and Dick K. Nanto, or CRS Report RL33536, *China-U.S. Trade Issues*, by Wayne M. Morrison.

China not Hong Kong, including goods that contain Hong Kong components or involve final packaging in Hong Kong. The United States also counts Hong Kong as the destination of U.S. products sent there, even those that are then reexported to China. However, the PRC counts many of such reexported goods as U.S. exports to China. So by U.S. figures, U.S. exports to China tend to be understated, while by Chinese figures, Chinese exports to the U.S. tend to be understated. The net result is that China's reported trade surplus with the United States at \$114 billion in 2005 is slightly more than half the reported U.S. deficit with China of \$202 billion.

Table 5. U.S. Merchandise Trade Balances with Selected Nations: 2000-2005

(millions of U.S. dollars, census basis)

Country	2001	2002	2003	2004	2005
Total	-411,389	-470,104	-535,699	-651,521	-766,561
North America	-83,190	-86,920	-95,012	-110,832	-126,671
Canada	-53,266	-49,760	-54,396	-65,765	-76,522
Mexico	-29,924	-37,202	-40,616	-45,068	-50,149
Western Europe	-63,985	-89,218	-101,325	-114,077	-144,065
European Union	-60,856	-82,368	-94,262	-104,510	-122,427
United Kingdom	-599	-7,617	-8,772	-10,442	-12,435
Germany	-29,037	-35,852	-39,199	-45,855	-50,663
France	-10,400	-9,389	-12,153	-10,574	-11,445
Italy	-13,908	-14,201	-14,867	-17,378	-19,496
Netherlands	10,024	8,471	9,731	11,682	11,634
Russia	-3,548	-4,473	-6,170	-8,930	-11,336
Pacific Rim Countries	-194,393	-215,005	-229,968	-282,534	-328,567
Japan	-68,962	-70,055	-65,965	-75,194	-82,682
China	-83,045	-103,115	-123,961	-161,978	-201,626
Newly Industrialized Countries (NICS)	-21,093	-22,073	-20,867	-21,925	-15,939
Singapore	2,712	1,429	1,418	4,295	5,529
Hong Kong	4,423	3,283	4,692	6,496	7,429
Taiwan	-15,240	-13,805	-14,122	-12,886	-12,788
Republic of Korea	-12,988	-12,979	-12,865	-19,829	-16,109
South/Central American Countries	-38,982	-17,902	-26,821	-37,323	-50,691
Argentina	913	-1,595	-734	-359	-472
Brazil	1,466	-3,403	-6,666	-7,294	-9,091
Colombia	-2,091	-2,018	-2,631	-2,785	-3,431
OPEC	-39,688	-34,482	-51,037	-71,867	-92,732
Venezuela	-9,552	-10,662	-14,305	-20,181	-27,556
Indonesia	-7,605	-7,063	-7,000	-8,142	-8,971
Saudi Arabia	-7,363	-8,364	-13,473	-15,678	-20,398
Nigeria	-7,829	-4,907	-9,365	-14,694	-22,573

Sources: United States Census Bureau, Foreign Trade Statistics. For other countries and further detail, see U.S. International Trade in Goods and Services, December 2005, FT 900 (05-12), released February 10, 2006.

Note: Trade Balance equals Total Exports (f.a.s. value) minus General Imports (Customs value).

Table 6 lists the U.S. top deficit trading partners (merchandise trade). In 2000, China overtook Japan as the top U.S. deficit trading partner. The next highest deficit trading partners are Japan, Canada, Germany, Mexico, and Venezuela.

Table 6. Top U.S. Merchandise Deficit Trading Partners, 2005
(Billions of U.S. Dollars)

Total U.S.	Balance	Exports	Imports
Total U.S.	-766.8	904.3	1,671.1
China	-201.6	41.8	243.5
Japan	-82.7	55.4	138.1
Canada	-76.5	211.3	287.9
Germany	-50.7	34.1	84.8
Mexico	-50.1	120.0	170.2
Venezuela	-27.6	6.4	34.0
Malaysia	-23.3	10.5	33.7
Nigeria	-22.6	1.6	24.2
Saudi Arabia	-20.4	6.8	27.2
Italy	-19.5	11.5	31.0
Ireland	-19.3	9.3	28.6
Korea	-16.1	27.7	43.8
Taiwan	-12.8	22.1	34.8
Thailand	-12.7	7.2	19.9
United Kingdom	-12.4	38.6	51.1
France	-11.4	22.4	33.8
Russia	-11.3	3.9	15.3
India	-10.8	8.0	18.8

Source: U.S. Department of Commerce.

Note: Data are on a census basis. Imports are on a Customs basis.

In 2005, Canada was America's largest merchandise trading partner, followed by Mexico, China, Japan, and Germany (China overtook Japan for third place in 2003). **Table 7** lists the United States' top trading partners ranked by trade turnover. Trade with Canada accounts for 20% of total U.S. trade. By far, Canada is the largest supplier of U.S. imports and the top purchaser of U.S. exports. Trade with Mexico accounts for 12%, and trade with China at 10% now exceeds that with Japan at 8%.

Table 7. Top U.S. Trading Partners Ranked by Total Merchandise Trade in 2005
(Billions of U.S. dollars, customs basis)

Rank	Country/Group	Balance	U.S. Exports	U.S. Imports	Total Trade
—	Total, all countries	-766.4	904.4	1,670.7	2,575.1
—	Total, top 15 countries	-601.5	653.1	1,254.6	1,907.6
1	Canada	-76.6	211.3	287.9	499.2
2	Mexico	-50.2	120	170.2	290.2
3	China	-201.7	41.8	243.5	285.3
4	Japan	-82.7	55.4	138.1	193.5
5	Germany	-50.7	34.1	84.8	119.0
6	United Kingdom	-12.5	38.6	51.1	89.7
7	Korea, South	-16.1	27.7	43.8	71.4
8	Taiwan	-12.8	22.0	34.8	56.9
9	France	-11.4	22.4	33.8	56.2
10	Malaysia	-23.3	10.5	33.7	44.2
11	Italy	-19.5	11.5	31.0	42.5
12	Netherlands	11.6	26.5	14.9	41.4
13	Venezuela	-27.6	6.4	34.0	40.4
14	Brazil	-9.1	15.3	24.4	39.8
15	Ireland	-19.3	9.3	28.6	38.0

Source: U.S. Department of Commerce.

Note: Data are on a census basis. Imports are on a Customs basis.

Table 8 lists trade balances on goods, services, and income, net unilateral transfers and current account balances for selected U.S. trading partners. While trade in services, flows of income from investments, and remittances home by foreign workers are considerably smaller than merchandise flows, as the economy has become more globalized and service oriented, these components of the current account have become more important. In many cases, the bilateral current account balances are quite different from bilateral balances on merchandise trade only.

Table 8. U.S. Current Account Balances With Selected U.S. Trading Partners, 2005
(billions of U.S. dollars)

Country	Merchandise Trade Balance ^a	Services Balance ^b	Investment Income Balance ^c	Net Unilateral Transfers ^d	Current Account Balance ^e
All Countries	-782.7	66.0	11.3	-86.1	-791.5
Mexico	-51.8	5.6	0.6	-11.0	-56.5
Canada	-81.1	10.2	19.4	0.0	-51.5
Asia/Pacific	-369.6	30.0	-35.9	-13.7	-389.2
Japan	-84.7	18.7	-33.3	0.7	-98.7
China	-201.7	2.6	-19.0	-1.9	-220.1
S. Korea	-16.6	3.1	-0.7	-0.6	-14.8
European Union	-124.4	12.2	-25.4	-3.8	-141.5
Germany	-51.0	-5.3	-1.7	-0.9	-58.9
United Kingdom	-13.0	8.9	-21.1	4.2	-20.9
Latin America	-102.5	1.7	12.3	-26.7	-115.3

Source: U.S. Bureau of Economic Analysis, International Transactions Account Data.

- a. On a balance-of-payments basis.
- b. Includes travel, transportation, fees and royalties, insurance payments, other government and private services, and investment income.
- c. Income receipts on U.S. assets abroad minus income payments on foreign assets in the United States.
- d. International transfers of funds, such as private gifts, pension payments, and government grants for which there is no *quid pro quo*.
- e. The trade balance plus the service balance plus investment income balance plus net unilateral transfers, although equal to the current account balance, may differ as a result of rounding.

For example, since Japan has invested considerable amounts in securities and stocks, and in factories in the United States, it had a surplus of investment income from the United States in 2005 of \$33 billion. This more than offset the \$18 billion in U.S. net exports of services to Japan. As a result, the current account deficit with Japan of \$99.2 billion in 2005 exceeded the merchandise trade deficit of \$84.8 billion. A similar situation exists with the European Union. In 2005, the United States accrued a \$32.5 billion deficit in investment income with the EU, and the current account deficit with the EU of \$141.5 billion exceeded the deficit in merchandise trade of \$124.4 billion. The opposite is the case with Canada where the United States received \$20 billion more in investment income than it paid to Canadians. While the current account deficit with Canada was \$51.5 billion, the merchandise trade deficit was \$81.1 billion.

The rising deficit with many countries in investment income reflects the accumulating debt relative to the world of the United States. Inflows of capital to compensate for the U.S. trade deficit and low U.S. savings rate help to maintain the value of the dollar, but interest paid and other income that accrues to that capital is often repatriated to the home countries. That means more capital must be invested in the United States or the United States must export more to compensate for the outflows of investment income. Currently, the United States still has a \$11 billion surplus in investment income overall, but the deficit in investment income with certain countries has been growing and could become a problem in the future.

Advanced Technology, Autos, and Oil

Table 9 shows U.S. trade in advanced technology products. This includes about 500 commodity codes representing products whose technology is from a recognized high technology field (e.g., biotechnology) or that represent the leading technology in a field. The United States long ran a surplus in these products, but that surplus dropped sharply in 2000 and turned into a deficit in 2002. In 2003, the deficit in U.S. trade in advanced technology products jumped 65% to \$27.4 billion, again rose in 2004, and in 2005 was \$44.4 billion. This does not necessarily imply the United States is losing the high technology race; many of the high technology imports are from U.S. companies (particularly electronics manufacturers) who assemble the products overseas. However, this growing deficit may warrant closer policy scrutiny.

Table 9. U.S. Trade in Advanced Technology Products
(billions of U.S. dollars)

Year	U.S. Exports	U.S. Imports	Trade Balance
1990	93.4	59.3	34.1
1995	138.4	124.8	13.6
1996	154.9	130.4	24.5
1997	179.5	147.3	32.2
1998	186.4	156.8	29.6
1999	200.3	181.2	19.1
2000	227.4	222.1	5.3
2001	200.1	195.3	4.8
2002	178.6	195.2	-16.6
2003	180.2	207.0	-26.8
2004	201.4	238.3	-36.9
2005	215.6	260.0	-44.4
January-Sept 2005	184.5	211.3	-26.8
January-Sept 2006	157.9	188.8	-30.9

Source: U.S. Bureau of the Census. *U.S. International Trade in Goods and Services*. FT-900, issued monthly. Includes about 500 of some 22,000 commodity classification codes that meet the following criteria: (1) contains products whose technology is from a recognized high technology field (e.g., biotechnology), (2) represent leading edge technology in that field, and (3) constitute a significant part of all items covered in the selected classification code.

Table 10 provides data on trade in passenger cars with major automobile producing nations for 2003. This does not include foreign cars assembled in the United States. The United States incurs the largest deficits in this trade with Japan, Canada, Germany, Mexico, and South Korea.¹²

¹² For information on the automobile industry, see CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D. Yacobucci.

Table 10. U.S. Trade in Passenger Automobiles by Selected Countries, 2005
 (millions of U.S. dollars)

Trading Partner	U.S. Exports	U.S. Imports	Trade Balance
Total World	30,410	123,644	-93,234
Japan	536	35,139	-34,603
Canada	12,038	36,330	-24,292
Germany	3,701	20,308	-16,607
Korea	115	8,769	-8,654
Mexico	3,374	10,826	-7,452
United Kingdom	844	5,701	-4,857

Source: U.S. Bureau of the Census, *U.S. International Trade in Goods and Services*, FT-900, issued monthly.

Table 11 show imports of crude petroleum by major country source. Roughly half comes from the Organization of Petroleum Exporting Countries (OPEC) with Saudi Arabia, Venezuela, and Nigeria the predominant suppliers. Half, however, comes from non-OPEC sources, such as Canada, Mexico, and Angola.¹³

Table 11. U.S. Imports of Crude Oil by Selected Countries, 2005
 (Quantity and Customs Value)

Country	Quantity (Thousand barrels)	Customs Value (\$million)
Total World	3,753,088	175,563
OPEC Total	1,818,357	88,303
Saudi Arabia	524,129	24,739
Venezuela	535,718	24,074
Nigeria	396,918	21,904
Kuwait	80,396	3,702
Algeria	82,383	4,670
Other OPEC	198,813	9,214
Non-OPEC Total	1,934,732	87,260
Canada	567,676	24,148
Mexico	552,076	23,096
Angola	161,507	8,161
Ecuador	99,128	4,223
Norway	43,107	1,947
Gabon	55,792	2,759
Other Non-OPEC	455,446	22,926

Source: U.S. Census Bureau, *U.S. International Trade in Goods and Services*, FT-900, issued monthly.

¹³ For detail, see CRS Report RS22204, *U.S. Trade Deficit and the Impact of Rising Oil Prices*, by James K. Jackson.

Some Common Perceptions

This section of the report addresses a few common perceptions about trade that can be validated by data.

Outsourcing

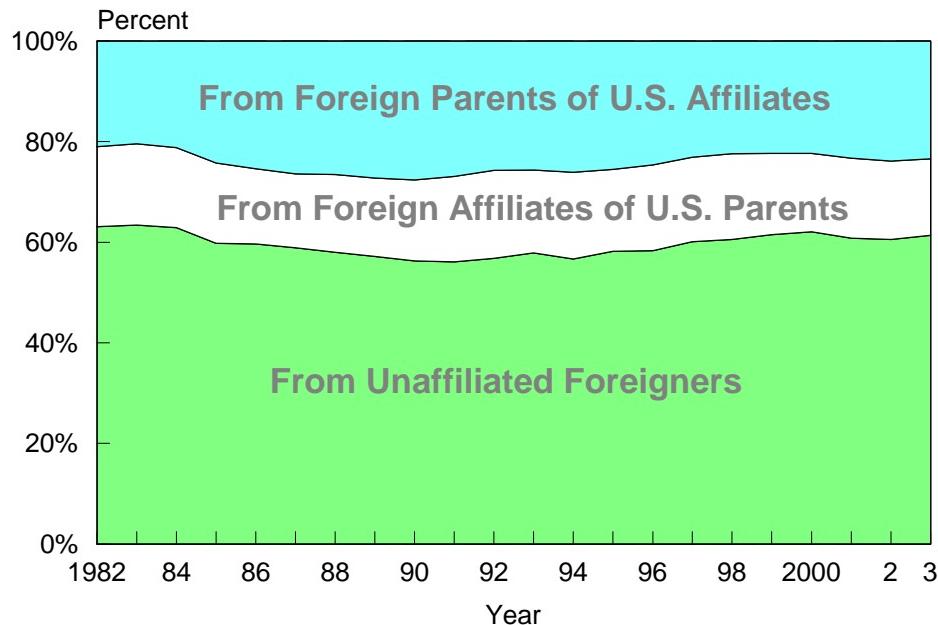
A common perception is that an increasing amount of U.S. imports are actually goods manufactured overseas by U.S. affiliated companies. U.S. manufacturers have moved production abroad in search of lower production costs or other economic advantages and are sending their product back to the American market.

Figure 9 shows the percentage of U.S. imported manufactured products by affiliation of the foreign producer. The total value of such imports from foreign affiliates of U.S. parent companies rose from \$39.3 billion in 1982 to \$191.9 billion in 2003, but the percentage of total U.S. imports accounted for by these imports has been fairly constant at around 16%. In 1982, such imports accounted for 15.9% of total imports, while in 2008 they accounted for 16.3% of the total. These are products such as American branded computers assembled in China in a subsidiary affiliated with a U.S. company.

The share of imports from foreign parent companies with affiliates in the United States has been rising somewhat — from 21.0% in 1982 to 25.5% in 2003. These reflect the growing foreign direct investment in the United States and include imports such as transmissions from a Japanese automaker for use in its assembly plant located in the United States.

Imports from unaffiliated foreigners accounts for about 60% of all imported goods. Their share has fallen somewhat from 63.2% in 1982 to 58.2% in 2003.

Figure 8. Shares of U.S. Imports of Manufactures by Affiliation of Foreign Producer, 1982-2003



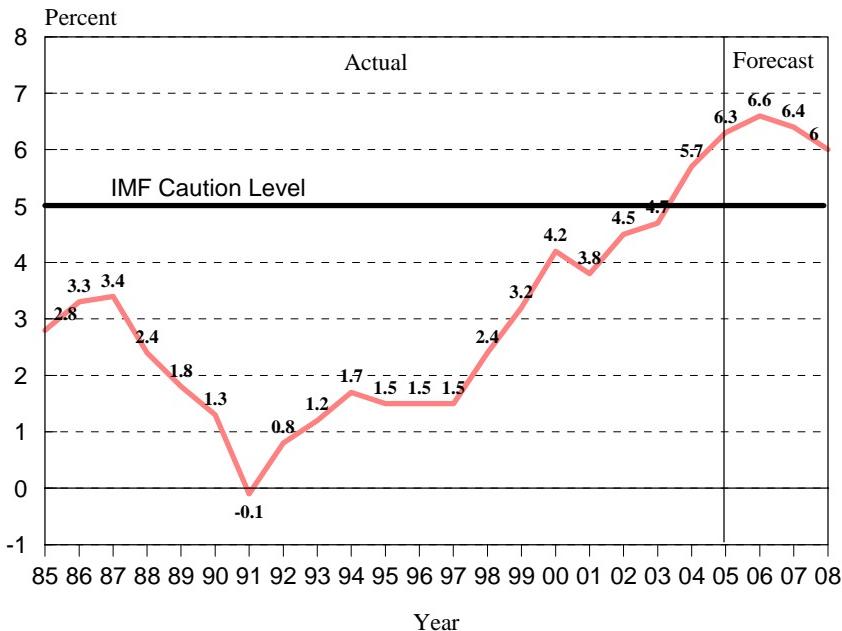
Source: CRS with Data from U.S. Department of Commerce

Is the Trade Deficit at a Dangerous Level?

The International Monetary Fund has used its experience with currency and exchange rate crises to say that caution should be exercised when a nation's current account deficit reaches a level of 5% of gross domestic product. At this level, nations have difficulty borrowing to finance imports and the nation's exchange rate may come under severe downward pressure. The United States is a special case, since the dollar is a secondary medium of exchange (one can use dollars in many foreign countries without exchanging them for local currency) and dollars are used extensively as an official reserve currency by national banks. Still, the IMF has been warning that the size of the U.S. current account deficit could cause a large depreciation of the dollar and disrupt financial markets.

Figure 9 shows the U.S. current account balance as a percent of U.S. gross domestic product. It grew in magnitude from near zero in 1980 to 3.4% in 1987, dropped into negative in 1991 and rose to 6.3% in 2005 (exceeding the 5% level considered to warrant caution by the International Monetary Fund). Rising energy costs are expected to push the current account deficit to about 6.6% of GDP in 2006 before it then begins to decline slightly. This indicates that downward pressures on the value of the dollar are likely to arise. Congress may consider measures to bring the size of the current account deficit relative to GDP to less than 5%.

Figure 9. The U.S. Current Account Deficit as a Percent of Gross Domestic Product, 1985-2008 (forecast)



Source: Data from U.S. Department of Commerce. Forecasts by Global Insight, Inc.

Is Trade with China Merely Replacing that with Southeast Asia?

Some observers claim that the rising U.S. imports from China are merely displacing those from other East Asian nations. Labor intensive industries, such as apparel, shoes, and consumer electronics, that produce for export to the United States and other industrialized nations are simply moving to China from Southeast Asian nations, South Korea, and Taiwan. The overall level of imports from Asia is not changing. Its composition is just shifting toward China.

For specific industries, the shift in imports from traditional Asian exporting nations to China is clear. In woven apparel (HS 62), for example, in 1990, Hong Kong, South Korea, and Taiwan accounted for 33.4% of U.S. imports as compared to China with a 14.7% share. By 2005, China accounted for 27.3% of such imports as compared with 6.3% for Hong Kong, South Korea, and Taiwan.

In terms of overall imports, however, U.S. imports from Hong Kong, Taiwan, and South Korea rose from \$50.6 billion (10.2% of total U.S. imports) in 1990 to \$87.5 billion (5.2% of total) in 2005, while imports from China rose from \$15.2 billion (3.3% of total) in 1990 to \$243.5 billion (14.6% of total) in 2005.¹⁴ Clearly, the share of U.S. imports from Hong Kong, Taiwan, and South Korea has been falling, while the share of imports from China is rising. The value of U.S. imports

¹⁴ The numbers are comparable for all Asian countries.

from both, however, continues to rise, and the value of those from China is rising faster.

The large U.S. trade deficit with China, moreover, is not just a transfer of the deficit from other Asian nations to China. The U.S. trade deficit with Hong Kong, Taiwan, and South Korea has gone from \$17.9 billion (17.5% of the total U.S. deficit) in 1990 to \$21.3 billion (2.8% of the total) in 2005. U.S. trade with Hong Kong actually went from a deficit to a surplus. The U.S. trade deficit with China, meanwhile, went from \$41.1 billion (10.2% of the total U.S. trade deficit) in 1990 to \$201.5 billion (26.3% of the total) in 2005. What actually is happening is that the U.S. trade deficit is rising with most regions of the world, particularly with Asia (including China), and it also is rising with Canada and Mexico, the European Union, and with oil exporting countries.